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IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,
v.
SOUTH CAROLINA DEPARTMENT
OF REVENUE AND TAXATION,
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of South Carolina

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the "substantial nexus" requirement of the Commerce Clause or the "minimum contacts" requirement of the Due Process Clause precludes a state from imposing an income tax upon a corporation with no physical presence in the state but whose trademarks are used in the state by a licensee.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, the respondent was referred to as the South Carolina Tax Commission. However, effective July 1, 1993, the South Carolina Tax Commission was transferred to and incorporated in the South Carolina Department of Revenue and Taxation pursuant to 1993 S.C. Acts 181, § 1-30-95.

RULE 29.1 STATEMENT

Petitioner Geoffrey, Inc. is a wholly-owned subsidiary of TRU, Inc., which is a wholly-owned subsidiary of Toys "R" Us-N.J., Inc., which is a wholly-owned subsidiary of Toys "R" Us, Inc. Petitioner has no subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

Geoffrey, Inc. respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of South Carolina in this case.

OPINIONS BELOW

The opinion of the Supreme Court of South Carolina (App. A at 1a-11a) has not yet been reported. The opinion of the Court of Common Pleas of Greenville County, South Carolina (App. B at 12a-27a) is unreported. The Finding of the South Carolina Tax Commission (App. C at 28a-31a) is unreported.

JURISDICTION

The judgment of the Supreme Court of South Carolina was entered on July 6, 1993. The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const., art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the Fourteenth Amendment of the United States Constitution, U.S. Const., amend. XIV, § 1, provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law."

Relevant portions of the South Carolina statutes are set forth at App. E at 34a-36a.

STATEMENT

This case raises a question of extraordinary importance to state taxpayers and state taxing authorities throughout the nation: whether a state may levy a tax upon a corporation with no physical presence in the state. Less than two years ago, the Court gave a negative answer to that question in adjudicating the constitutionality of a state's attempt to impose a use tax collection obligation upon a mail-order seller with no physical presence in the state. *Quill Corp. v. North Dakota,* 112 S. Ct. 1904 (1992). The Court in *Quill,* however, specifically left open the question whether the "bright-line, physical-presence requirement" (*id.* at 1916) applicable to sales and use taxes would apply as well to other types of state taxes. *Id.* at 1914-16. That issue is squarely presented by this case.

1. The Facts

Petitioner Geoffrey, Inc. ("Geoffrey") is a Delaware corporation with its principal place of business in Wilmington, Delaware. During the years in question, Geoffrey was a second-tier subsidiary of Toys "R" Us, Inc.

("Toys 'R' Us"), the world's largest retailer of children's toys.[1]

a. ***The creation of Geoffrey***

In 1984, in conjunction with a corporate restructuring at Toys "R" Us, Geoffrey was organized for the purpose of holding and managing the trademarks of Toys "R" Us. R. 42-43.[2] These trademarks included the "Toys 'R' Us" trademark as well as related marks ending with " 'R' Us" ("Kids 'R' Us," "Books 'R' Us," "Sports 'R' Us," etc.).[3] By placing its trademarks in a separate subsidiary, Toys "R" Us could control the principal functions associated with the trademarks, such as licensing and defending them,[4] through a discrete and specialized legal entity. Segregation of the trademarks also enabled Toys "R" Us to measure more accurately the contribution that the trademarks were making to its overall organization (R. 43) and to ensure "that they would not get comingled [*sic*] with what was going on with the rest of the organization." R. 43.

b. ***The location of Geoffrey***

The corporate restructuring that, among other things, transferred the "Toys 'R' Us" trademarks to Geoffrey also

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[1] During the tax years at issue (1986 and 1987), Geoffrey was a wholly-owned subsidiary of TRU, Inc., which, in turn, was a wholly-owned subsidiary of Toys "R" Us. Since 1991, Geoffrey has been a third-tier subsidiary of Toys "R" Us. *See* Rule 29.1 Statement.

[2] Citations to the Record on Appeal in the Supreme Court of South Carolina are designated "R." followed by a page reference.

[3] The distinctive character of the mark is accentuated by the fact that, as actually displayed, the "R" is backwards.

[4] Over the years, Geoffrey has brought numerous lawsuits in the federal courts to protect its trademarks from infringement. In June 1990, at the time of the hearing before the South Carolina Tax Commission, fourteen such actions were pending. R. 41, 160-61.

offered Toys "R" Us the opportunity to realize state tax savings in limited circumstances. By holding the trademarks in Geoffrey, and having Geoffrey license the trademarks for a royalty to Toys "R" Us, its affiliates, and unrelated parties, Toys "R" Us could reduce its state tax liability without any offsetting increase in Geoffrey's tax liability if (1) Geoffrey were located in a state that did not tax its income, and (2) Toys "R" Us operated in a state that measured its tax liability without combining its income with that of its affiliates, such as Geoffrey. Under these conditions, Toys "R" Us' taxable income would be decreased due to the deductible royalty payments made to Geoffrey. The corresponding increase in Geoffrey's royalty income, however, would not be taxed by the state where Geoffrey was located.

In light of these potential state tax savings, when Toys "R" Us created Geoffrey in January 1984, it chose to establish it in Delaware. Delaware has long sought to attract corporations to the state by, among other things, exempting from income tax corporations whose activities within the state "are confined to the maintenance and management of their intangible investments" such as trademarks. Del. Code Ann. tit. 30, § 1902(b)(8) (1985 & Supp. 1992). Toys "R" Us responded to that incentive by locating its trademark licensing company in Delaware. R. 43-44.

c. The trademark license agreement

In August 1984, following the transfer of "Toys 'R' Us" and related trademarks to Geoffrey, Geoffrey entered into a license agreement with Toys "R" Us granting Toys "R" Us a nonexclusive license to use the trademarks in its United States business (except for five states). R. 116-33. Under the license agreement, Toys "R" Us agreed to pay Geoffrey one percent of the net sales of products sold

or services rendered under the licensed mark. R. 119. Geoffrey also entered into similar license agreements with other related and unrelated corporations. R. 36, 213. Toys "R" Us reports its sales revenues to Geoffrey on an aggregate basis without attributing the revenues to any particular state. R. 37-38, 120.

d. *Geoffrey's contacts with South Carolina*

When Geoffrey and Toys "R" Us entered into their trademark license agreement, Toys "R" Us was not doing business in South Carolina. It was not until October 1985, more than a year after the license agreement was executed, that Toys "R" Us opened its first store in South Carolina. R. 33. During the tax years at issue (1986 and 1987),[5] Toys "R" Us earned income from its South Carolina operations on which it paid South Carolina income taxes of $25,843 and $68,438. R. 162, 187. During this period, Toys "R" Us paid royalties to Geoffrey on Toys "R" Us' sales, including those from South Carolina.[6] At no time did Geoffrey have any employees, offices, or real or tangible personal property in South Carolina.

2. The Assessment

The South Carolina Tax Commission (the "Commission")[7] conducted an income tax audit of Toys "R" Us for tax years 1986 and 1987. As a result of the audit, the

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[5] Both Geoffrey and Toys "R" Us reported on a fiscal year basis ending February 2, 1986, and February 1, 1987.

[6] As noted above, Toys "R" Us did not report its royalties to Geoffrey on a geographically identifiable basis. The South Carolina Tax Commission apparently determined the amount of Geoffrey's royalties attributable to South Carolina by taking one percent of the South Carolina sales that Toys "R" Us reported in apportioning its income to the state. R. 103.

[7] Effective July 1, 1993, the South Carolina Tax Commission was transferred to and incorporated in the South Carolina Department of Revenue and Taxation pursuant to 1993 S.C. Acts 181, § 1-30-95.

Commission proposed income tax deficiencies against Toys "R" Us. R. 215-22. Insofar as here relevant, the proposed assessment was initially based on the Commission's position that Toys "R" Us was not entitled to deduct the royalties it had paid to Geoffrey because Geoffrey was "a paper corporation" (R. 219) and the royalty expenses paid to Geoffrey entailed "an arbitrary shift" (R. 219) of income and expenses. After Toys "R" Us protested the assessment on the grounds, among others, that there was no basis for disregarding Geoffrey as a separate corporate entity or for questioning the fairness of the royalty payments made by Toys "R" Us to Geoffrey,[8] the Commission advanced an alternative argument, which is the focus of this petition: namely, that Geoffrey itself, wholly apart from its status as a subsidiary of Toys "R" Us, was subject to tax in South Carolina on the royalties it received as a result of Toys "R" Us' South Carolina operations.

Following a hearing, the Commission reversed its initial position attacking Geoffrey's status as a separate corporate entity and the arm's-length basis for the license agreement. It concluded instead that "the royalty payments to Geoffrey by Toys are deductible by Toys as part of the computation to arrive at Toy's [*sic*] apportionable income." App. C at 29a. At the same time, however, the Commis-

[8] Unlike many states, *see* 1 Multistate Corporate Income Tax Guide (CCH) ¶ 185 (1993), South Carolina does not require combined reporting of unitary affiliates for state income tax purposes. Rather, it strictly respects the separate status of related corporate entities. S.C. Code Regs. 117-77 (1992). The South Carolina Supreme Court's comment that Geoffrey "paid no income taxes to any state" (App. A at 3a n.1) is thus misleading and irrelevant. In fact, Geoffrey's income was effectively included in the apportionable tax base of every state in which Toys "R" Us filed combined reports. In any event, the fact that Delaware, for legitimate reasons of state policy, has chosen not to tax the income of companies like Geoffrey does not enlarge South Carolina's power to tax such income.

sion found that Geoffrey had a sufficient nexus with South Carolina to subject it to tax on the royalties derived from Toys "R" Us' South Carolina sales. *Id.* On this basis, it issued a notice of assessment against Geoffrey for $10,612 taxes plus interest. R. 258.[9]

3. The Decisions Below

After paying the contested taxes under protest, Geoffrey brought suit for a refund challenging the assessment on the ground, among others, that Geoffrey lacked a sufficient nexus with South Carolina to satisfy the requirements of the Commerce and Due Process Clauses. R. 26-27. Ruling without the benefit of this Court's opinion in *Quill*, the trial court rejected Geoffrey's constitutional claims. The court proceeded from the premise—subsequently repudiated in *Quill* (112 S. Ct. at 1913)—that "[t]he United States Supreme Court has found that the requirement for satisfying a 'minimal connection' for nexus is the same for both Due Process and Interstate Commerce." App. B at 19a. On this assumption, the court viewed its task as "simply one of asking whether the state has provided some protection, opportunity, or benefit for which it can ask a return." *Id.*

The court found South Carolina had met this standard with respect to Geoffrey on two theories. First, the court viewed Geoffrey's "exploitation of [the] state's market" (App. B at 20a) as "a sufficient basis upon which to find a valid nexus" (*id.*) under the Due Process and Commerce Clauses regardless of the taxpayer's physical presence in the state. Second, the court found that Geoffrey's

[9] At the same time, the Commission assessed Geoffrey with a minimum corporate license fee, which is based on capital employed in South Carolina, of $15 per year for the periods ending January 31, 1987, and January 31, 1988. R. 259. Geoffrey's constitutional objections to the South Carolina income tax are equally applicable to the license fee, and its petition for review of the judgment below is directed to both taxes. Because of the relative insignificance of the license fee, however, no further reference will be made to it in this petition.

intangible property—in the form of a franchise and the receivables arising out of the license agreement—was "located in South Carolina" (*id.* at 21a), thus providing a second predicate for South Carolina's constitutional nexus with Geoffrey.

The Supreme Court of South Carolina affirmed. Devoting most of its analysis to Geoffrey's due process claim, the court observed that "[t]he nexus requirement of the Due Process Clause can be satisfied even where the corporation has no physical presence in the taxing state if the corporation has purposefully directed its activity at the state's economic forum." App. A at 4a (citing *Quill*). Although Toys "R" Us had no South Carolina stores when it entered into the trademark license agreement with Geoffrey, the court determined that Geoffrey had nevertheless purposefully directed its activities towards South Carolina "[b]y electing to license its trademarks and trade names for use by Toys R Us in many states" without prohibiting their use in South Carolina. *Id.* at 5a.

Like the trial court, the South Carolina Supreme Court relied on "the presence of Geoffrey's intangible property in this State" (App. A at 5a) as an alternative ground for its due process determination. The court found that the situs of Geoffrey's franchise and accounts receivable was in South Carolina and that the "presence" of these intangibles provided the "'minimum connection'" between Geoffrey and the state required by the Due Process Clause. *Id.*

The South Carolina Supreme Court disposed of Geoffrey's Commerce Clause claim in two brief paragraphs. App. A at 9a-10a. It put *Quill* to one side on the premise that *Quill*'s reaffirmation of the physical-presence requirement applied solely to sales and use taxes. *Id.* at 9 n.4. The court therefore did not consider whether the concerns that animated the Court's adoption of the bright-line, physical-presence requirement in *Quill*—the burden that a more flexible rule would impose on interstate com-

merce and respect for *stare decisis*—were equally applicable to the case at hand. Instead, the South Carolina court relied on the same considerations that underlay its due process analysis—the existence of state-provided protections and benefits—in concluding that Geoffrey had a "substantial nexus" with South Carolina under the Commerce Clause. *Id.* at 10a.

REASONS FOR GRANTING THE PETITION

The South Carolina Supreme Court has issued a decision with staggering implications for taxpayers doing business across state lines, particularly the ever-increasing number of taxpayers who deal with intangible property. In substance, the court has held that, regardless of a taxpayer's tangible contacts with a state, the taxpayer is subject to the state's constitutional taxing jurisdiction so long as the taxpayer derives some economic benefit from the state's market. Under the court's holding, an author paid royalties by a publisher from the sale of a book would be subject to tax in every state in which the book was sold. A television producer paid royalties by a network for the use of a program would be subject to tax in every state in which the program was televised. An electronic data bank receiving payments for the use of its services would be subject to tax in every state in which its logo flashed across the computer screen.

There are three compelling reasons for the Court to grant review of the decision below. First, the decision raises an issue of utmost importance to the Court's Commerce Clause jurisprudence: whether a state may impose an income tax on a taxpayer with no physical presence in the state. The Court left this fundamental constitutional question open in *Quill*, and it should settle it now. Second, wholly apart from any Commerce Clause restraint on state taxation, the case presents a substantial question under the Court's Due Process Clause jurisprudence: whether a trademark licensor has "purposefully directed" its activity towards any state in which the licensee exploits the

trademark and, if so, whether the assertion of taxing jurisdiction under these circumstances would comport with " 'fair play and substantial justice.' " *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985) (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945)). Extreme uncertainty regarding the meaning of the Court's personal jurisdiction cases and their impact in the state tax context warrants additional guidance from this Court. Finally, the basic tax nexus issue presented by this case is one of enormous practical significance that will create chaos in interstate tax administration unless resolved by this Court.

I. THIS COURT SHOULD RESOLVE THE QUESTION WHETHER *QUILL*'S "BRIGHT-LINE, PHYSICAL-PRESENCE" STANDARD APPLIES TO STATE CORPORATE INCOME TAXES

In *Quill*, this Court held that the "substantial nexus" requirement of the Commerce Clause precludes a state from compelling a mail-order vendor with no physical presence in the state to collect use taxes on goods sold to in-state purchasers. In so holding, the Court differentiated the nexus requirements of the Due Process and Commerce Clauses:

> [T]he due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him . . . . In contrast, the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.

Quill, 112 S. Ct. at 1913. Based on these Commerce Clause concerns, and on considerations of *stare decisis*, the Court reaffirmed the "bright-line, physical-presence requirement" (*id.* at 1916) of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), for state jurisdiction to impose sales and use taxes.

While reaffirming the physical-presence nexus requirement for sales and use taxes, the Court observed in *Quill* that it had not explicitly extended that requirement to other types of taxes. Thus the Court noted that "we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* establishes for sales and use taxes" (*Quill,* 112 S. Ct. at 1914) and that "in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement . . . ." *Id.* at 1916. At the same time, however, the Court warned that "silence does not imply repudiation of the *Bellas Hess* rule" (*id.* at 1914) and that the reasoning of its cases outside the sales and use tax area did "not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Id.* at 1916. So, too, the Court's silence in those cases does not compel a rejection of a physical-presence requirement for other types of taxes.

The uncertainty thus created by *Quill* over the application of the bright-line, physical-presence standard outside the area of sales and use taxes is an unresolved constitutional question of major dimension that warrants this Court's plenary consideration. Its resolution plainly should not be left to the perfunctory treatment it received at the hands of the court below. That court dismissed the question in a footnote, misreading this Court's statement that it had not explicitly "articulated" (*Quill,* 112 S. Ct. at 114) a physical-presence requirement outside the sales and use tax context as meaning that such a requirement had been rejected in every other taxing context. App. A at 9a n.4.

As this Court pointed out in *Quill,* however, precisely the opposite was true. All of the cases which the state court in *Quill* had invoked as eroding the physical-presence requirement "involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* . . . ." *Quill,* 112 S. Ct. at 1914. Indeed, the Court has *never* held in *any*

state tax case that the nexus requirement of the Commerce Clause can be satisfied in the absence of a taxpayer's physical presence in the state.[10] It is hardly the prerogative of a state court to determine that this unbroken line of precedent should be abandoned; that there is one nexus standard governing sales and use taxes and another for all other types of taxes;[11] and that a sea change is to be made in this Court's Commerce Clause doctrine. For these reasons alone, it is incumbent upon this Court to review the decision below.

Moreover, the essential question whether the Court's Commerce Clause jurisprudence should be modified outside the sales and use tax context cannot be answered intelligently without considering the factors that led the Court to reaffirm the physical-presence standard in *Quill*. In *Quill*, the Court noted the benefits of a "bright-line" rule which avoids "[u]ndue burdens on interstate commerce . . . by the demarcation of a discrete realm of commercial activity that is free from interstate taxation."

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[10] In purported support of the allegedly "well settled" proposition "that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there" (App. A at 9a), the court below cited two cases: *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441-42 (1944), and *Curry v. McCanless*, 307 U.S. 357, 368 (1939). Each case is irrelevant on two counts. First, neither case involved the Commerce Clause; the cases raised only due process issues. Second, in both cases the state's taxing power was exerted with respect to physically-present entities—the tax-withholding corporation in *International Harvester* and the local trust companies in *Curry*.

[11] Indeed, this dubious distinction has already been rejected by one state court. *Guardian Indus. Corp. v. Department of Treasury*, 198 Mich. App. 363, 377, 499 N.W.2d 349, 356 (1993) (Commerce Clause "substantial nexus" test of physical presence applies to Michigan Single Business Tax); *cf. D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988), where the Court observed that the four-pronged Commerce Clause test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), applied uniformly to a wide variety of state taxes, in response to the taxpayer's argument that the test did not apply to a tax on goods in the stream of commerce. Brief for Appellant at 16-24, *D.H. Holmes*.

Quill, 112 S. Ct. at 1914. Such a rule "firmly establishes the boundaries of legitimate state authority"; it "reduces litigation"; it "encourages settled expectations and, in doing so, fosters investment by businesses and individuals"; and, when long-standing precedent supports the rule, it serves the " 'interest in stability and orderly development of the law' that undergirds the doctrine of *stare decisis* . . . ." *Id.* at 1915-16.

The court below did not even purport to consider these factors. Thus it failed to consider whether the case for a "bright-line" rule of "substantial nexus" is any less compelling in the income tax context than in the sales and use tax context; it failed to consider whether the "settled expectations" (*Quill*, 112 S. Ct. at 1915) of income taxpayers are any less worthy of constitutional respect than the settled expectations of sales and use taxpayers; and it failed to consider whether "principles of *stare decisis*" (*id.* at 1916) are less relevant to income taxes than to sales and use taxes, particularly when Congress has the ultimate power to prescribe the appropriate rules in this area. *Id.* In fact, each one of these factors applies with equal force to state income taxpayers as to state sales and use taxpayers. Consequently, unless this Court grants review to explore these questions, the South Carolina court effectively will have engineered a dramatic change in the Commerce Clause restraints on state taxation by judicial fiat.

Finally, even if the Court were to determine that the bright-line, physical-presence standard of "substantial nexus" had no application outside the sales and use tax area, the Court's guidance is sorely needed nonetheless to give content to the concept of "substantial nexus." To be sure, the Court indicated in *Quill* that "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Quill*, 112 S. Ct. at 1913. Accordingly, the Court further observed, "a corporation may have the 'minimum con-

tacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 1913-14. But these thoughts were entirely lost on the court below, which simply applied a due process "benefits-and-protections" analysis in finding "substantial nexus" under the Commerce Clause. *See supra* pp. 8-9. In light of the manifest burdens that will be imposed on interstate commerce if the ruling below is allowed to stand unrevised, *see infra* pp. 20-23, it is essential for this Court to review this case and to delineate the meaning of "substantial nexus" in a manner that is more protective of Commerce Clause concerns.

II. THE STATE COURT'S RULING THAT A LICENSEE'S USE OF A TRADEMARK IN A STATE CONFERS JURISDICTION TO TAX AN OUT-OF-STATE LICENSOR RAISES A SUBSTANTIAL DUE PROCESS QUESTION WARRANTING THIS COURT'S REVIEW

As this Court explained in *Quill*, the due process restraints on state power to tax are "[c]omparable" to those on state power to adjudicate. *Quill*, 112 S. Ct. at 1911. Under the Court's contemporary due process jurisprudence, a state's power to adjudicate (and thus, presumptively, to tax) depends on "whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice." ' " *Id.* at 1910 (quoting *International Shoe*, 326 U.S. at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940))). Under this two-pronged analysis, a state may subject a foreign corporation to its adjudicatory or taxing jurisdiction under the Due Process Clause only if (1) "a defendant purposefully established minimum contacts within the forum State," *Burger King*, 471 U.S. at 476, and, if so, (2) "the assertion of personal jurisdiction would comport with 'fair play and substantial justice.' " *Id.* (quoting *International*

Shoe, 326 U.S. at 320). Whether Geoffrey is subject to tax by South Carolina under either of these criteria raises a substantial question of national significance warranting this Court's attention.

A. The Decision Below Raises the Substantial Question Whether a Trademark Licensor "Purposefully" Establishes "Minimum Contacts" with a State by Virtue of the Licensee's Use of the Trademark in That State

The initial due process question raised by this case is whether Geoffrey, by licensing Toys "R" Us to use its trademarks, has "purposefully avail[ed] itself of the benefits of an economic market" (*Quill*, 112 S. Ct. at 1910) in South Carolina because Toys "R" Us uses Geoffrey's trademarks there. Although Toys "R" Us had no stores in South Carolina when Geoffrey and Toys "R" Us entered into their license agreement, and Geoffrey had no role in Toys "R" Us' decision to enter the South Carolina market, the court below nevertheless concluded that Geoffrey had "purposefully directed its activities toward South Carolina's economic forum . . . ." App. A at 5a. The court inferred such "purposeful direction" from the fact that Geoffrey had not prohibited Toys "R" Us from using the trademarks in South Carolina and that Geoffrey "contemplated" and was "aware of" the possibility that its trademarks might be used in South Carolina. *Id.* The conclusion, however, that the mere foreseeability of a trademark licensee's future choice to use the mark in a state suffices to subject that corporation to the state's jurisdiction under the Due Process Clause is highly questionable in light of *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102 (1987).

In *Asahi*, Justice O'Connor, writing for herself, the Chief Justice, and Justices Powell and Scalia, expressed the view that the Due Process Clause requires "something more than that the defendant was aware of its product's entry into the forum State through the stream of com-

merce in order for the State to exert jurisdiction over the defendant." *Asahi*, 480 U.S. at 111. Rather, "[t]he 'substantial connection' . . . between the defendant and the forum State necessary for a finding of minimum contacts must come about by *an action of the defendant purposefully directed toward the forum State.*" *Id.* at 112 (emphasis in original). Consequently, "a defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream of commerce into an act purposefully directed toward the forum State." *Id.* Justice Stevens likewise recognized the existence of a constitutional line between " 'mere awareness' that a component will find its way into the forum State and 'purposeful availment' of the forum's market." *Id.* at 122 (Stevens, J., concurring in part and concurring in the judgment).[12]

Under the views expressed by Justice O'Connor in *Asahi*—views utterly ignored by the court below—it is apparent that there is a substantial due process question raised by South Carolina's assertion of jurisdiction to tax Geoffrey. There was no "action *of the defendant* purposefully directed toward the forum State." *Asahi*, 480 U.S. at 112 (original emphasis partially omitted). Rather, by licensing Toys "R" Us to use its trademarks, Geoffrey was merely releasing its intangible "product" into the stream of commerce. Whether that "product" would find its way into South Carolina was wholly within the control

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[12] Justice Stevens did not believe, however, that this line was "unwavering" (*Asahi*, 480 U.S. at 122), and felt that the determination whether such conduct "rises to the level of purposeful availment requires a constitutional determination that is affected by the volume, the value, and the hazardous character of the components." *Id.* Justice Brennan, writing for himself and Justices White, Marshall, and Blackmun, was of the view that a defendant who can reasonably anticipate that its products will be distributed in a state has sufficient contacts with a state to be subject to the state's jurisdiction. *Id.* at 117-21.

of Toys "R" Us. The state court's speculation that Geoffrey could have "contemplated" or been "aware of" the possibility that Toys "R" Us might in the future use Geoffrey's trademarks in South Carolina does not establish that Geoffrey "purposefully directed" its activities towards the South Carolina market. *See also World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980) (foreseeability that product sold by out-of-state wholesaler and retailer might be used in state insufficient to establish jurisdiction over wholesaler and retailer under Due Process Clause).

Apart from the state court's questionable reliance on a "foreseeability" standard of jurisdiction, Geoffrey's relationship with South Carolina failed to satisfy the Court's "minimum contacts" standard. Geoffrey had no palpable contacts with South Carolina: all of Geoffrey's dealings were with the Toys "R" Us out-of-state headquarters; Geoffrey had no officers, agents, or tangible property in South Carolina; it did not advertise or otherwise solicit business in South Carolina; it did not create or control a distribution system there; and it did not establish channels for providing regular advice to customers there. Geoffrey's contacts with South Carolina thus fall short of the "minimum contacts" the Court has found sufficient to sustain a state court's jurisdiction in other cases. *See Burger King* (minimum contacts established where out-of-state franchisee entered into contract with franchisor headquartered in forum state, where all relevant payments were sent, agreements were made and enforced, and decision-making authority was exercised); *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770 (1984) (minimum contacts established where out-of-state defendant continuously and deliberately exploited the forum state's market by monthly distribution of thousands of magazines); *Quill* (minimum contacts found where defendant systematically exploited the forum state by soliciting business through catalogs, flyers, and other media).

Finally, the decision below is rendered no less suspect constitutionally by its suggestion that the "minimum contacts" requirement was "satisfied by the presence of Geoffrey's intangible property in [South Carolina]." App. A at 5a. The theory of *in rem* jurisdiction on which the suggestion is based—that the presence of a nonresident defendant's property in the state automatically provides a predicate for asserting jurisdiction over the nonresident—was repudiated by this Court in *Shaffer v. Heitner*, 433 U.S. 186 (1977). In *Shaffer*, the Court abandoned the distinction between *in rem* and *in personam* jurisdiction for due process purposes and held that all assertions of jurisdiction must be evaluated according to the "minimum contacts" standard of "fair play and substantial justice" established by *International Shoe* and its progeny. *Shaffer*, 433 U.S. at 212. Accordingly, even if the fiction were embraced that Geoffrey's intangible property is "located" in South Carolina for some purposes, that conclusion would not establish jurisdiction to tax under modern due process analysis.

B. The Decision Below Raises the Substantial Question Whether the Establishment of Jurisdiction over an Out-of-State Trademark Licensor Because the Trademark Is Used in the State by the Licensee Offends "Traditional Notions of Fair Play and Substantial Justice"

Wholly apart from the substantial question whether Geoffrey has sufficient "minimum contacts" with South Carolina to satisfy the due process requirements, the case raises an equally substantial question under the second prong of the Court's due process analysis: whether the assertion of jurisdiction "would offend '"traditional notions of fair play and substantial justice."'" *Asahi*, 480 U.S. at 113 (citations omitted). The court below simply ignored this issue.

It is plain that South Carolina's assertion of taxing jurisdiction in this case raises significant fairness concerns

to Geoffrey and to similarly situated taxpayers throughout the United States. *See infra* pp. 20-23. Under the ruling below, any person who licenses another to use a patent, copyright, or similar intangible would find itself subject to tax in any jurisdiction in which the licensee chose to use the intangible. A licensor like Geoffrey would be forced either to monitor closely the business activities of each of its licensees to determine to what extent the licensee's activities in various states were generating portions of its income or to risk widespread exposure to taxation in state and local taxing jurisdictions with which it has no contact. In light of self-reporting requirements and severe penalties for noncompliance, not to mention the inapplicability of any statute of limitations to taxpayers who have not filed returns, the burden that either alternative would impose on Geoffrey and innumerable other taxpayers would be overwhelming.

While the interest of the taxing state must likewise be considered, the state's claim for a "fair share" of tax revenues would appear to be at its weakest when income from intangibles is at issue. A licensor of intangibles with no physical presence in the state imposes virtually no social costs on the state. It has no employees that receive police protection or property that receives fire protection. It does not use the state's roads, navigate its waters, or utilize its landfills.

However the Court might ultimately strike the balance, the question whether the assertion of jurisdiction in this case comports with "traditional notions of fair play and substantial justice" merits this Court's consideration.

III. THE QUESTION PRESENTED HAS ENORMOUS PRACTICAL SIGNIFICANCE AND SHOULD BE RESOLVED BY THIS COURT TO AVERT CHAOS IN INTERSTATE TAX ADMINISTRATION

The practical implications of the South Carolina Supreme Court's sweeping conception of state tax jurisdiction are simply astonishing. Under the court's ruling, whenever a person's intangible property is used by others, the person will be subject to tax wherever such property is used. A small, start-up company in Silicon Valley will be subject to tax in every state in which its software licensees operate, even if, like Geoffrey, it has no office, employees, or tangible property in the state and has never solicited business there. A bank purchasing a security representing a bundle of loans will be subject to tax in every state in which the underlying borrowers reside because, just as "[t]he real source of Geoffrey's income is not a paper agreement, but South Carolina's Toys R Us customers" (App. A at 8a), so the "real source" of the bank's income is not the security but the underlying borrowers spread across the nation. An athlete receiving royalties from his or her endorsement of a product will be subject to tax in every state in which the product is sold, regardless of any other connection the athlete may have had with the state, because the athlete, like Geoffrey, failed to prohibit the use of the endorsement in those states, and thus "consented to, and benefitted from" (App. A at 5a) the licensee's use of intangible property in the state. A company receiving payment for a covenant not to compete will be taxable in every state in which it has agreed *not* to do business because that is where the covenantee is enjoying the intangible rights that are the "source" of the covenantor's income. The list goes on and on. *See supra* p. 9.

Nor is this parade of horribles imaginary. State tax officials across the country have already seized upon the *Geoffrey* case as a vehicle for expanding their jurisdiction

to tax. The Wisconsin Department of Revenue, which in the past had "not aggressively asserted the licensing of intangibles as a nexus-creating event," is "monitoring *Geoffrey* to decide how aggressively to pursue this issue." Robert M. Fahrenbach, *DOR to Monitor* Geoffrey *Case, Intercompany Transactions,* State Tax Notes, July 26, 1993, at 200. The Florida Department of Revenue "published a substantial rewrite of the rules governing the state's corporate income tax . . . to provide an indication of . . . the department's position on issues similar to those raised in South Carolina in the *Geoffrey (Toys "R" Us)* case." William D. Townsend, *Revenue Department Drafts Substantial Rewrite of Corporate Income Tax Rules,* State Tax Notes, July 5, 1993, at 7.[13] And the Federation of Tax Administrators has advised its members that, if Geoffrey failed to seek Supreme Court review, "the case could become a basis for other state courts to hold companies subject to income and franchise taxes on the basis of economic presence. Companies particularly at risk would be those who provide services, such as financial institutions, and brokers." Federation of Tax Administrators, *South Carolina High Court Applies* Quill *Decision,* Tax Administrators News, July 1993, at 69, 80.

Indeed, petitioner has been made acutely aware of the national implications of the South Carolina Supreme

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[13] The proposed changes in Florida's corporate income tax rules (Rule 12C-1.011) provide in part:

> (1) The following activities . . . will be construed as conducting business, earning or receiving income in this state . . . .
>
> (r) selling or licensing the use of intangible property in Florida. For example, licensing the use of a trade name or trademark to a franchise.

Florida Department of Revenue Rewrites Corporate Income Tax Rules, Fla. Admin. Weekly, Vol. 19, No. 24, June 18, 1993, *available in* LEXIS, FLA Library, FLADMN File, 93 STN 125-2.

Court's decision. Shortly after the decision below was rendered, the Multistate Tax Commission's "National Nexus Program" contacted Toys "R" Us indicating its "understand[ing] that . . . Geoffrey, Inc. may be transacting . . . business . . within the jurisdiction of various states" and observing that "[m]any states impose income tax nexus based on minimal activities (including the licensing of intangible property rights) performed within the State." Letter from Alice J. Davis, Director, Multistate Tax Commission, National Nexus Program, to John Salvia, Tax Manager, Toys R Us, August 20, 1993 (reproduced in full in App. D).

The burdens that this expanded state tax jurisdiction will impose on taxpayers, particularly small and medium-sized business, are immense. Corporations deriving income from intangible property exploited by others across state lines will suddenly find themselves saddled with the obligation to comply with the tax laws of dozens of states with which they have no familiarity. They will be required to file estimated and final returns, maintain records, and engage legal and accounting personnel to comply with the states' self-reporting requirements, upon the pain of large penalties should they fail to do so. The risks of noncompliance are exacerbated by the fact that taxpayers who have failed to file returns are not protected by statutes of limitations. The cost of complying with the varying income tax regimes of different states may well exceed the burden of the taxes themselves, especially in the case of small companies. In fact, the taxes involved in this case amount to less than $11,000 for the two years at issue (R. 258)—an amount that already has been dwarfed by the cost of compliance.

Even on the most sanguine of assumptions regarding taxpayers' ability to comply with the South Carolina Supreme Court's brave new world of state taxing jurisdiction, the court's decision, if left undisturbed, will spawn uncertainty and confusion in state tax administration.

Indeed, the Michigan Court of Appeals, in a decision that directly conflicts with the decision of the court below, has held that *Quill's* bright-line, physical-presence standard of Commerce Clause nexus is not limited to sales and use taxes. *Guardian,* 198 Mich. App. at 377, 499 N.W.2d at 356. Only by resolving the key issues raised by the decision below will the Court be able to stem the inevitable tide of litigation and concomitant disarray that will burden state taxpayers and state tax administrators alike.

CONCLUSION

The decision below has created a critical need for further guidance from this Court. Not only does it raise substantial, unresolved questions under the Commerce and Due Process Clauses, it also produces practical problems of enormous significance that demand this Court's attention.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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